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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.
No. 968

WILLIAM C. HAY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

PETITION FOR REHEARING OF DENIAL OF CERTIORARI.

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To the Honorable Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

Your petitioner, a British subject, by his counsel, prays for a rehearing with respect to his petition for certiorari, denied March 26, 1945, and respectfully shows:

1. This Court may have been misled by respondent's inexcusably incomplete and distorted paraphrasing of Sections 112(b)(5) and (i).[1] All that petitioner asks

[1]Respondent's Brief in Opposition, pp. 18-19, footnote 4. For basis of petitioner's assertion in this regard, see *infra*, p. 5.

is that Section 112, which draws no distinction between citizens and aliens, be applied to him in the same manner as it would have been applied, on identical facts, to a citizen. Is a friendly alien entitled to less?

2. The decision below conceals as pernicious and subversive a construction of Section 112 as would a decision that respondent has the power to impose a tax on an exchange made by a negro that would unquestionably be tax-free (non-recognized) if made by a white person. It holds in effect that although the August 6 exchange would have been substantial enough, separate enough, and final enough to have *required* respondent to collect a tax of nearly $500,000 thereon if it had been made by a citizen, it was not an "exchange" within Section 112(a) simply because made by a nonresident alien outside the United States. Is this equal justice under law?

3. Respondent admits that a distribution in liquidation is not a "dividend" when the stockholder is a nonresident alien not engaged in business in the United States, but asserts that it is a "dividend" to a nonresident alien who is so engaged. [1a] This is unprincipled policy-making by an administrative official not consonant with fair play.

4. The decision below circumvents the declared policy of Congress not to tax nonresident aliens on income from sources without the United States by ignoring the undisputed finding that the transfers of title in the December exchange took place in Nassau.

[1a] Respondent's Brief in Opposition, note 4, pp. 18-19.

ARGUMENT.

I.

Solely Because Petitioner Is a Nonresident Alien, Respondent Would Ignore the Plain Language of Section 112 and Reverse Settled Principles of Law Applicable to the Exchange of August 6.

On the August 6 branch of the case the crux of respondent's argument appears on page 14 of his brief, as follows:

> * * * Accordingly, whatever the Nassau corporation did must be deemed to have been done by taxpayer. When he exchanged his Hay, Ltd. stock for the Nassau corporation stock, he made an exchange with himself which had no substantive effect; the transaction was a mere formality. The Commissioner was not bound *to assess a tax*[2] on this transaction under Section 112(i) and, in that way, aid in the consummation of taxpayer's plan for tax avoidance which Congress, in Section 112(i) itself, intended to forestall. * * * (Italics supplied.)

Every one of these contentions is the complete opposite of the unquestionably correct principles that would have *required* the Commissioner to assess a tax on the August 6 exchange if petitioner had been a citizen, and which would have prevented the Commissioner from taxing a citizen on the December liquidation.

If a citizen had made the exchange of August 6, both the letter and policy of Sections 112(a) and (i) would

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[2]Section 112(i) does not "assess a tax"; it goes only to the matter of *recognition* of gains. Other sections, including Section 212(a), determine whether a tax is assessed in a particular case.

have *required* the Commissioner to treat the Nassau corporation as a separate entity, and not as an agent of its sole stockholder.[3] Congress, in enacting these statutory provisions, drew no distinction between citizens and nonresident aliens.[4] Is it fair play for an administrative official to draw a distinction based *solely* on petitioner's being a nonresident alien? Is it fair play to treat a foreign corporation as the agent of an alien when the same corporation, in identical circumstances, would not be treated as the agent of a citizen?

Is it fair play for the Commissioner to say that an exchange with a valid foreign corporation is a "mere formality" without "substantive effect" *solely* because made by a nonresident alien, when it is indisputable that a citizen, in identical circumstances, would have realized a "recognized" gain on which the Commissioner unquestionably would have been "bound to assess a tax"?

Is it fair play for the Commissioner to contend that the August 6 exchange was "interlocutory"[5] solely because made by a nonresident alien *outside* the United States, when it clearly would have been treated *by the statute* as

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[3]This Court rejected the agency argument in *Moline Properties, Inc. v. Commissioner,* 319 U. S. 436, erroneously decided by the same judge of the Tax Court who decided the case at bar.

[4]Compare, by analogy, *Gcorday Enterprises v. Commissioner,* 126 F. (2d) 384, at 389 (C. C. A. 4, 1942) and *Capital Estates, Inc. v. Commissioner,* 138 F. (2d) 156, at 157 (C. C. A. 3, 1943).

[5]Respondent's Brief, p. 10, last line.

"isolated"[6] and final if made by a citizen—or if made by petitioner *within* the United States.[7]

Is it fair play for the Commissioner to distort the true meaning of Section 112 by an inexcusably erroneous paraphrasing (Respondent's Brief, p. 12, note 1) of Sections 112(b)(5) and (i)—a paraphrasing which *omits* the words "or loss" which appear in Section 112(b) (5) and which neglects to inform this Court that Section 112(i) operates to *withdraw* nonrecognition only of *gains*, while *preserving* nonrecognition of *losses*? ("Withdraws" is the word used in the committee reports explaining the purpose and effect of Section 112(k) of the Revenue Act of 1932, the precursor of Section 112(i) of the Act of 1936.[8]) A reading of Sections 112(a), (b) (5), and (i) together shows that the congressional purpose of Section 112(i) can be achieved *only* by treating a *foreign* corporation as a separate entity under Section 112(a)[9] and by treating *each* exchange (where there are two or more) as an "isolated" and final transaction. Only by treating each exchange as *separate* can the nonrecognition of *loss* be preserved.

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[6]Respondent's Brief, p. 13, 12th line from bottom.

[7]If the property which petitioner exchanged on August 6 had been "real property located in the United States" the gain would not only have been "recognized" because of Sections 112(a) and (i) but would have been taxable as gross income of a nonresident alien because attributed by Section 119(a)(5) to "sources *within* the United States." Compare *Texas-Canadian Oil Corp.*, 44 B. T. A. 913 (1941).

[8]See Appendix to Petition herein, pp. 27-29, reprinting the relevant portion of Sen. Rep. No. 665, 72nd Cong., 1st Sess., 1939-1 Cum. Bull. (Part 2), p. 515.

[9]Otherwise, as Mertens points out, there could never be a taxable transaction; see Law of Federal Income Taxation, Mertens, Vol. 3, §20.13 at page 117.

In *Texas-Canadian Oil Corp.*, 44 B. T. A. 913 (1941),[10] the Commissioner persuaded the Tax Court that Section 112 "can not be ignored" (p. 919) for any reason. That decision is unquestionably correct.[11] The gain there was from the exchange of "*real* property located in the United States" and therefore, under Section 119(a) (5), was "treated as income from sources within the United States" even though the exchange "was consummated outside the United States." (p. 919) The gain would have been non-recognized except for Section 112(i).

Section 112(i) is not limited to transfers of *real* property to a foreign corporation. Is it fair play to say that gain on transfers of United States *real* property will be "recognized" in all cases, but that gain on transfers of *personal* property will not be "recognized" where they are made by a nonresident alien outside the United States? Is it fair play for the judiciary to read Section 112 with one eye on Section 212(a)—to say that a transaction is not an "exchange" within Section 112(a) if it gave rise to gain excluded from an alien's gross income by Section 212(a)?

The *Texas-Canadian* case is the only reported decision directly involving Section 112(i). It was called to the attention of both courts below. They chose to treat it as non-existent. Respondent has never attempted to distinguish it. It is impossible to give effect to that decision

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[10]The taxpayer's appeal to C. C. A. 5 was dismissed November 20, 1942, 424 C. C. H. p. 1071, 30 A. F. T. R. 1735.

[11]Mertens says of the *Texas -Canadian* case that "In view of the sweeping language of the section [112(i)], no other conclusion seems warranted." Law of Federal Income Taxation, Mertens, Vol. 3, p. 116, note 7.

and sustain the tax here involved. It would be impossible to collect a tax from a citizen if Section 112(i) were ignored.

Respondent erroneously asserts[12] that "The plan executed by taxpayer was one predicated principally upon Sections 112(i) and 119(e) * * *." This assertion, so far as it relates to Section 112(i), is without warrant in the record. If Section 112(i) had never been enacted, petitioner would nevertheless have realized a gain on August 6 under Section 112(a). Since that exchange was consummated outside the United States, the gain, whether "recognized" or not, was excluded from petitioner's gross income by Section 212(a). When a nonresident alien brings a transaction within Section 212(a), that is the type of tax avoidance contemplated by that provision, not the type condemned by the principles of cases like *Gregory v. Helvering*, 293 U. S. 465, and *Higgins v. Smith*, 308 U. S. 473, upon which respondent relies. This is shown by the facts and opinion in a latter decided case, *Elston Co., Ltd.*, 42 B. T. A. 208 (June, 1940), in which profits on *several* sales of securities by a foreign corporation were held taxable to the extent consummated *within* the United States but free from tax where the sales were made *outside* the United States.[13]

In *Higgins v. Smith*, 308 U. S. 473, this Court said (p. 477):

> * * * The Government * * * may sustain or disregard the effect of the fiction as best serves the

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[12]Respondent's Brief, p. 12, 14th line.

[13]The Commissioner's appeal in the *Elston* case was dismissed by the Fourth Circuit Feb. 3, 1941. C. C. H. 1945 Index Volume, p. 19,414.

> purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. * * *

May the Commissioner "sustain or disregard" depending on whether the sole stockholder is a citizen or an alien? May the Commissioner "supersede legislation" such as Section 112(i), which is bottomed on recognizing, not disregarding, the separate entity of a foreign corporation in exchanges resulting in gains? Obviously the Commissioner could not, and would not, "disregard" the Nassau corporation if the recipient of its shares on August 6 were a citizen. His wish to do so here (while inconsistently seeking to take advantage of what that corporation actually did in December)[14] springs *solely* from the *existence and applicability* of Section 212(a). Thus, it is the Commissioner, not the taxpayer, who would "supersede legislation" here.

How can any court, in justice, disregard a substantial, valid and permanent corporation, created for legitimate purposes[14a] by an alien under the laws of his own sovereign, when it is construing a statute that would *compel* recognition of the same corporation, whatever its purposes, if petitioner had been a citizen?

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[14]Petitioner's Nassau corporation owned assets worth over $2,500,000 for over four months before it liquidated Hay, Ltd. and, as the undisputed findings show, still owned all these assets five years later.

[14a]The undisputed finding is that "Colonial Trust Co., Ltd., was incorporated for the primary purpose of removing the situs of petitioner's wealth from the United States with a view to avoiding estate taxes in the United States. * * *." [R. 61-62.]

II.

Respondent's Brief and the Decision Below Ignores Decisions of This Court Holding That a Distribution in Liquidation Is Not a Dividend.

Even if the August 6 gain, taxable to a citizen, is ignored here, respondent can not win unless the December 10 liquidation was a "dividend" within Section 119(a)(2). Because of this, respondent's brief[15] makes the following astounding assertion:

> * * * But although liquidating dividends, to the extent that they are distributions of earnings and profits accumulated after February 28, 1913, come within the definition of a "dividend" contained in Section 115(a) * * *

In *Helvering v. Credit Alliance Corp.*, 316 U. S. 107 at 110, this Court said:

> * * * a distribution in liquidation *of earnings* * * * does not constitute a dividend in the proper sense of the term, * * *. (Italics supplied.)

It required a *special* statutory provision to permit the Credit Alliance Corporation to treat the liquidation distribution "as a taxable dividend paid" because it was not a "dividend" to the stockholder-distributee. A distribution is not a "dividend" unless made by a *going* corporation "in the ordinary course of business." *Hellmich v. Hellman*, 276 U. S. 233, 237. The Treasury has profited greatly by the "exchange" concept of a distribution in liquidation. See *Canal-Commercial Trust & Savings Bank v. Commissioner*, 63 F. (2d) 619, certiorari denied, 290 U. S. 628, and *Texas-Empire Pipe Line Co. v. Commissioner*, 42 B. T. A. 368, reversed on another point, 127 F. (2d) 220.

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[15]Respondent's Brief, p. 16, lines 6 to 10.

Why should the statutory—and realistic—"exchange" concept be abandoned in favor of the "dividend" concept when the Commissioner rightly concedes that he can not treat a distribution in liquidation as a "dividend" in taxing nonresident aliens not engaged in business in the United States?

III.

The Decision Below Ignores the Settled Rule That Profit on a Sale or Exchange of Personal Property Is Made Where the Final Act Making the Transfer Effective Takes Place.

On December 10, 1937, Hay, Ltd. was present in Nassau, represented by its directors and officers, residents of that place. The Nassau corporation at that place exchanged the shares for the assets. Under California law the exchange took place in Nassau. *Balconades Ballroom, Inc. v. Superior Court*, 109 Cal. App. 612, 615.

If, as respondent asserts, a distribution in liquidation is a unilateral act, it was in this case, as the undisputed findings show, the act of the Nassau corporation; that corporation, as the stockholder, brought about the liquidation. But the real answer is that Congress has seen fit to treat the stockholder as giving up his shares in "exchange" for assets. The question is where did the stockholder transfer the title to his shares, not where did the corporation get the assets which it distributed.

That the "profit" on a sale (or its exact equivalent in tax law, an exchange) of personal property is made where the final act making the transaction effective takes place, is familiar law in this Court. *Compania General de Tabacos v. Collector*, 279 U. S. 306, 309. The "profit" on

the December 10 exchange was made in Nassau. Not being from a source within the United States, it could not be taxed to a nonresident alien without giving the revenue laws an extraterritorial effect in defiance of the expressed will of Congress, which, conscious of the country's international obligations, sought—ineffectually in this case—to place its fiscal agencies under a decent restraint.

Conclusion.

The importance and nature of the matters involved would seem to justify asking this Court to investigate whether the purpose and intent of the revenue laws have been subverted in fundamental respects and in a manner to deprive an alien of the basic concepts of fair play.

It is submitted that the order of March 26, 1945, should be vacated and that the petition should be granted.

Respectfully submitted,

JOSEPH D. BRADY,
Attorney for Petitioner.

WALTER L. NOSSAMAN,
Of Counsel.

April 12, 1945.

Certificate of Counsel.

The undersigned counsel of record hereby certifies that the foregoing petition is presented in good faith and not for delay.

JOSEPH D. BRADY,
Attorney for Petitioner.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of April, A. D. 1945.

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4-13-45—60